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Fund Finance Friday

# Rated Note Feeders and the Cayman Islands – Lender FAQs

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We are often asked by our clients: "What are you seeing? Anything interesting in the market on your side?" Our answer, as Cayman counsel, is more often than not that we are a ship floating in a tide and what they see as trends in the U.S. fund structuring and fund finance market will (or already have) washed up on our shores. One such trend that we continue to see progress in the market is in the confluence of the private equity and insurance sectors. This courtship is taking a variety of forms, but as private equity sponsors continue to look towards the vast reservoir of investable capital available in the insurance market, and insurers look back across the river at the stellar returns of such private equity sponsors, we are increasingly seeing the use of rated note feeders established as Cayman Islands limited liability companies (LLCs) or exempted limited partnerships (ELPs) to bridge the accessibility gap between insurers and private equity funds.

As one would expect, even though there are obvious structural differences between a "standard" feeder fund (where limited partners (LPs) hold equity interests in the feeder rather than debt instruments issued by the feeder) and a rated note feeder, sponsors still expect such feeders and their respective noteholders to be included in the borrowing base for subscription facilities and be treated to the extent possible as if they were a normal LP.

This note addresses some lender FAQs that we have encountered where a rated note feeder is a Cayman vehicle and is a potential credit party to a fund finance facility.

***What is a rated note feeder?***

The features of a rated note feeder formed in the Cayman Islands will in most cases be very similar to that of an equivalent Delaware vehicle other than the overlay of local law considerations discussed further below and will involve: (i) an LLC agreement or ELP LPA to form the vehicle; (ii) a note purchase agreement (NPA) pursuant to which the notes are constituted (and an associated offering memorandum for rating agency purposes in some instances); and (iii) a subscription agreement for notes (and, in some cases, a hybrid form allowing for part note and part ELP interest subscriptions). The overall goal and purpose of the documents, however, is to re-create to the extent possible the capital commitment and capital call mechanics of a standard private equity vehicle except constituted in this case as a commitment to fund advances for the issuance of notes.

***Is there any material difference from a Cayman perspective between: (i) taking security over call rights pursuant to the NPA (the right to call for advances from a noteholder) and (ii) taking security over capital call rights under the LPA?***

In short – no. Outside of the various tweaks to the security documents to appropriately reference and capture the specific rights in question, the Cayman analysis for taking security over rights emanating from a Cayman law-governed NPA is the same in all material respects to a grant of security over capital call rights contained in a Cayman law-

governed LPA. As a result of this, the assignment by way of security of such rights is typically captured in a New York law-governed security agreement (for North American-based deals).

***Are there any specific Cayman legal requirements in respect of taking security over rights emanating from a NPA?***

As mentioned above, the Cayman classification of such security is materially similar to that of security over capital call rights, and this rings true also for the question of how the secured party can perfect or gain priority of such security. For security over capital call rights, as most readers will be aware, a notice is commonly required by lenders to be sent to LPs post-closing to notify them of the security (which, from a Cayman perspective, obtains priority of the security interest for the secured party). The same analysis applies in the context of security over call rights contained in a Cayman law-governed NPA, and notice should be served on the noteholders post-closing in order to obtain priority of such security in the same fashion.

***Are Cayman rated note feeders caught within the scope of the Private Funds Act (PF Act) and required to register with the Cayman Islands Monetary Authority (CIMA)?***

Most of the Cayman rated note feeders that we have encountered to date have been created with one investor in mind and so, as a result, end up being single investor vehicles and not a “private fund” for the purposes of the PF Act. In other instances, however, we have seen note issuance feeders that have been a hybrid model of capital commitment and note commitments by multiple investors and, in these circumstances, the applicable vehicle has fallen within scope of the PF Act and, accordingly, the usual considerations (*i.e.*, registration, appropriate covenants in the transaction documents, etc.) would apply. Rated note feeders are by their very nature bespoke, and so careful analysis of the PF Act position is necessary in each case.